No. 82-599

In the Supreme Court of the United States

OCTOBER TERM, 1982

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

FRED L. AND MARY A. ENGLE, RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF RESPONDENTS

THOMAS J. DONNELLY
Counsel of Record
MICHAEL J. CONLAN
Quarles & Brady
780 North Water Street
Milwaukee, Wisconsin 53202
(414) 277-5000
Attorneys for Respondents, Fred L. and Mary A. Engle

QUESTION PRESENTED

Section 613A of the Internal Revenue Code, entitled "Limitations on Percentage Depletion in Case of Oil and Gas Wells", provides in subsection (c) that percentage depletion shall be computed in accordance with Section 613 with respect to so much of the taxpayer's "average daily production" of oil and gas as does not exceed his depletable quantity of oil and gas. Section 613(a) of the Internal Revenue Code provides that percentage depletion is to be computed at rates specified therein on the "gross income from the property." The question presented is whether Section 613A(c) precludes respondents, who received advance royalties and who otherwise would be entitled to the percentage depletion deduction, from entitlement to the deduction measured by the "gross income from the property" because there was no physical extraction of oil or gas from the property during the year 1975.

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BRIEF OF RESPONDENTS

Items (d), (e), (f) and (g) of Rule 34.1 of this Court are excluded from presentation here pursuant to Rule 34.2.

SUMMARY OF ARGUMENT

1. Recipients of advance royalties were entitled to percentage depletion deductions for almost fifty years prior to the Tax Reduction Act of 1975 (the "1975 Act"). The deduction was

allowed by §611 of the Internal Revenue Code of 1954 and was computed pursuant to §613 on the "gross income from the property." (Pet. App. 74a[1]).

2. Section 613A was incorporated into the Internal Revenue Code by the 1975 Act. This section limits the percentage depletion deduction to small independent producers and royalty owners whose oil and gas quantities do not exceed certain production limitations. Section 613A makes production a *limitation* to the deduction, not a prerequisite for the deduction. Large producers that exceed the limitations of §613A are not entitled to percentage depletion. The Conference Committee Report for the 1975 Act indicated that prior law concerning percentage depletion was retained by the 1975 Act with respect to small independent producers and royalty owners whose production quantities do not exceed the limitations. The Engles received advance royalties in 1975; their oil and gas quantities did not exceed the production limitations of §613A. They are entitled to the percentage depletion deduction.

3. The Commissioner attempts to find legislative intent for the 1975 Act (H.R. 2166) in the report of the House Committee on Ways and Means of a prior Congress on a bill (H.R. 17488) which simply died after being reported out by the House Committee of that prior Congress. H.R. 17488 was never considered by the Senate.

In the next Congress the House Committee version of H.R. 2166 retained the percentage depletion rules as they had existed for fifty years and in this respect was wholly different from H.R. 17488. The statutory language which is relevant to this case was added by the Senate when it considered H.R. 2166 in 1975. The Conference Committee report on H.R. 2166 makes no reference whatever to H.R. 17488 of the prior Congress. Instead the Conference Committee report makes reference to the

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[1]"Pet. App." refers to the appendix to the petition in this case.

retention of prior law with respect to percentage depletion. There is no logic to the Commissioner's attempt to derive the Senate's intent from a House report on a bill of a prior Congress which the Senate never considered.

4. In 1977 the Commissioner first proposed regulations under §613A (Proposed Regulations on Income Tax, Section 1.613A-7(f)(1)). These regulations are merely proposed regulations and have never been implemented. The proposed regulations require a computation of percentage depletion under §613A. Section 613, not §613A, provides for the computation. Proposed regulations which do not harmonize with the statutes cannot be relied upon. The Commissioner cites no case in which proposed regulations have been relied upon to interpret a statute. Proposed regulations have no standing and cannot be compared to longstanding final regulations which have been accepted for many years.

I. PRIOR TO THE ENACTMENT OF THE TAX REDUCTION ACT OF 1975 PERCENTAGE DEPLETION WAS ALLOWED WITH RESPECT TO ADVANCE ROYALTIES OR LEASE BONUSES, NOTWITHSTANDING THE ABSENCE OF PRODUCTION.

Prior to the enactment of the Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (the "1975 Act"), percentage depletion was clearly allowable with respect to advance royalties or lease bonuses. Percentage depletion was allowable pursuant to §611 and §613 of the Code. Section 611 set forth the general rule which provided that:

> *In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion. . .* §611(a), I.R.C.

Section 613 provided that the depletion allowance was to be a percentage of the annual *gross income* from the depletable property.

> *(a) General Rule. In the case of mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property. . .* §613(a), I.R.C.

Subsection (b) of §613, provided that the rate of depletion for "oil and gas wells" was 22 percent. It is noteworthy that actual production from the property in no way entered into the calculation, nor was it a necessary element of the depletion deduction; the only requirement was that there be *gross income*.

For almost fifty years, from 1926 through 1974, percentage depletion was allowed on the gross income from "oil and gas wells", regardless of whether there was production from the oil or gas well. The calculation was at all times based on the *gross income* from the property. During that half century the Commissioner made numerous attempts to impose production as a prerequisite for percentage (but not cost) depletion. *Herring v. Commissioner*, 293 U.S. 322 (1934), see also *Jahn v. C.I.R.*, 475 F.2d 1140 (6th Cir. 1973), aff'g 58 T.C. 452 (1972), and *Cox v. United States*, 497 F.2d 348 (4th Cir. 1974), cert. denied 419 U.S. 1047 (1974).

In *Herring*, the Commissioner contended that some minimal amount of production was necessary as a prerequisite for the percentage depletion deduction. The Comissioner's contention was based on the theory that because the statute allowed percentage depletion "in the case of . . . oil and gas wells", percentage depletion was not allowed unless a producing well existed. The Supreme Court rejected the Commissioner's position and stated:

> *To condition the allowance on actual production, however small, or the imminent probability of production, and to deal in refinements as to the degree of probability of future production, is in many cases to deny any deduction where the taxpayer elects to compute it under 204(c)(2), flat percentage of gross income from the property, and permit it where he elects to compute it under 204(c), on the basis of cost. But the nature and the purpose of the allowance is the same in both cases, and we find neither statutory authority nor logical justification for withholding it in the one and granting it in the other; much less for making the decision turn upon the circumstance that no production is obtained within the year in which the bonus is paid.* 293 U.S. at 327-8.

The Commissioner now resurrects the issue of whether production is required for percentage depletion and again attempts to differentiate between percentage depletion and cost depletion. He claims that the 1975 Act, though obviously it does not say that, gives him justification to do so. However, an examination of §613A of the Code, as added by the 1975 Act, demonstrates that there still is "neither statutory authority nor logical justification" for requiring production as a prerequisite for percentage depletion.

II. SECTION 613A(c) OF THE INTERNAL REVENUE CODE DOES NOT REQUIRE PRODUCTION AS A CONDITION OF ELIGIBILITY FOR THE EXEMPTION FOR INDEPENDENT PRODUCERS AND ROYALTY OWNERS, BUT MERELY PLACES A LIMITATION ON THE AGGREGATE AMOUNT OF PRODUCTION TO WHICH THE EXEMPTION APPLIES.

A. The 1975 Act retained existing law for taxpayers that do not exceed the production limits of §613A(c).

As was the case prior to the 1975 Act, §611 permits a reasonable allowance for depletion "[i]n the case of. . . oil and

gas wells. . ." and §613 provides an allowance for depletion based on gross income "in the case of mines, wells, and other natural deposits." However, effective for taxable years ending after December 31, 1974, §501 of the 1975 Act created §613A of the Code which eliminated percentage depletion in the case of oil and gas wells except as to (a) certain domestic ga. wells not in issue here and (b) independent producers and royalty owners as provided by §613A(c) of the Code.

The Engles clearly fall within the independent producers and royalty owners classification. They are "small producers" to which the exemption applies and are not disqualified on the basis of retailing or other activities. The Commissioner does not challenge this. Rather, he questions whether the Engles are eligible for the exemption provided for those who do fall within the exempt classification.

Section 613A(c) limits the independent producers and royalty owners exemption to certain quantities of production as specified therein. It provides in part that:

> *(c) Exemption for Independent Producers and Royalty Owners. —*
>
> (1) *In general. — Except as provided in subsection (d), the allowance for depletion under section 611 shall be computed in accordance with section 613 with respect to —*
>
> *(A) so much of the taxpayer's average daily production of domestic crude oil as does not exceed the taxpayer's depletable oil quantity; and*
>
> *(B) so much of the taxpayer's average daily production of domestic natural gas as does not exceed the taxpayer's depletable natural gas quantity;*
>
> *and the applicable percentage (determined in accordance with the table contained in paragraph (5)) shall*

> *be deemed to be specified in subsection (b) of section 613 for purposes of subsection (a) of that section.* §613A(c)(1), I.R.C.

For 1975 the percentage depletion deduction for independent producers and royalty owners was limited to 2,000 barrels of oil per day or 12 million cubic feet of natural gas (in the case of the production of both, the deduction was based on a formula which combined the two types of production), and the "applicable percentage" was 22 percent.

The basis of the exemption for independent producers and royalty owners is spelled out clearly in the Conference Committee Report on §501 of the 1975 Act as follows:

> *Senate amendment. — Under the Senate amendment, the deduction for percentage depletion is generally eliminated with respect to oil and gas produced on or after January 1, 1975, with certain exceptions. These include the exceptions provided under the House bill. In addition, the Senate amendment retains percentage depletion at 22 percent on a permanent basis for the small independent producer to the extent that his average daily production of oil does not exceed 2,000 barrels a day, or his average daily production of natural gas does not exceed 12,000,000 cubic feet. Where the independent producer has both oil and natural gas production, the exemption must be allocated between the two types of production.* H.R. Conf. Rep. No. 94-120, 94th Cong., 1st Sess. (1975) 1975-1 C.B. 624, 630-631). [Emphasis supplied.]

Thus, the Committee Report makes it clear that as to independent producers and royalty owners, *existing law is to be retained*, so long as the *quantities* applicable to the exemption *are not exceeded*. The Engles are obviously independent producers whose average daily production for 1975 did not exceed 2,000

barrels per day. The report indicates that as to taxpayers such as the Engles, percentage depletion is to be *retained*. The Commissioner contends, however, that it has not, in fact, been retained.

The Conference Committee Report repeatedly describes §613A(c) of the Code as the "small producer exemption." For example,

> ***Conference substitute.*** *— The conference substitute follows the Senate amendment in providing a small producer exemption from the repeal of percentage depletion. . .;*

and

> *The deduction resulting from the small producer exemption may not exceed 65 percent of the taxpayer's net income. . .;*

and

> *[T]here is no plowback requirement in connection with percentage depletion under the small producer exemption.* H.R. Conf. Rep. No. 94-120, 94th Cong., 1st Sess. (1975) (1975-1 C.B. 624, 630). [Emphasis supplied.]

The language of the report demonstrates that the intent of Congress in enacting §613A(c) was to exempt the small independent producer and royalty owner from the repeal of percentage depletion relating to oil and gas income. The "average daily production" formula was an attempt to define the term "small". It was not an effort to impose a production requirement in connection with the exemption. We think it is obvious that Engles are "small" royalty owners that the exemption of §613A(c) was intended to reach.

By imposing a production requirement, the Commissioner is attempting to base percentage depletion on production. However, percentage depletion is based upon and measured by the *gross income* from the property, not by production. §613(a), I.R.C. This was true before the 1975 enactment of §613A and continues to be true today. The Commissioner is attempting to do the same thing he did in *Herring*. There he argued that because the applicable statute was phrased in terms of "oil and gas wells", production was required. Now, after decades during which production was not required, the Commissioner is again attempting to impose a production requirement because a statute, §613A(c), imposes a *limitation* which is based on production.

B. There is no logical justification for making production a prerequisite to the allowance of percentage depletion for the recipient of advance royalties.

In *Herring* this Court stated that there was neither "statutory authority nor logical justification" for making production a prerequisite to percentage depletion. Even if the *Herring* decision and the fifty years of practice since *Herring* did not exist, the limitation language of §613A(c) would not constitute statutory authority for the imposition of a production requirement. There is no reference in §613A of the Code to a requirement that there be some minimal production in order to permit the application of the independent producer exemption. There is no indication in §613A(c) that it is intended to modify gross income as used in another section (§613(a)) of the Internal Revenue Code which for fifty years has included advance royalties. When the limitation language of §613A(c) is considered in the light of *Herring* and the fifty years of practice since that decision, the conclusion that there is no production requirement is compelling.

Furthermore, there continues to be no logical justification for requiring production. Section 613A(c) is designed to prevent

large producers from claiming substantial amounts of percentage depletion. There is no logical justification for permitting a person who produces one barrel of oil to claim percentage depletion while denying it to a person who has no production. The Engles did not exceed the limitation found in §613A(c) and are entitled to percentage depletion.

The Tax Court's belabored concurring opinion referred to §613A as a "mangled" statute (Pet. App. 33a). In its opinion that court attempted to impose the requirement that percentage depletion be somehow calculated on production (meaning physical extraction) whether or not there is any gross income from the property, and to change the provisions of §613(a) which in fact base the calculation on gross income. The Tax Court did this by repeatedly making reference to a production requirement so that the gross income basis for the calculation was obscured.

That statute is indeed "mangled" if one attempts to base the percentage depletion calculation, as the Tax Court did, on production rather than on gross income, or to view §613A(c) as anything more than a *limitation*. The title to §613A, "Limitations on Percentage Depletion in Case of Oil and Gas Wells," clearly indicates that the section imposes a limitation rather than making production a prerequisite. If Congress had intended that production become the new basis for percentage depletion under the small independent producer exemption, then we would find it difficult to understand why the formula for calculating it was not revised so as to base the calculation on production. Congress, however, not only expressed no such intention in drafting §613A(c), but also said in its Committee Report that present law was to be retained for the small independent producer.

Of course, in 1975 the law based percentage depletion on gross income, and gross income included advance royalties. The Commissioner and the Tax Court, therefore, had no justification in finding that the words "so much of the taxpayer's

average daily production" found in §613A(c)(1)(A) changed the formula for computing percentage depletion contained in §613. The statutes involved are "mangled" only if one attempts to justify the interpretation of the Commissioner and the Tax Court. Under the interpretation of the Engles and the Seventh Circuit, the relevant Code sections harmonize completely, they are easily understood, and, most importantly, the deduction is calculable under §613(a). Where an interpretation of the law has been in effect for 50 years, and such interpretation harmonizes with all other provisions which must be read in conjunction with it, that interpretation should be accepted. *National Muffler Dealers Association v. United States*, 440 U.S. 472 (1979).

Making physical extraction a prerequisite for percentage depletion could produce absurd results. Under such an interpretation, if there were one barrel of oil produced in a year, the taxpayer who received an advance royalty in that year could claim percentage depletion. If nothing were produced, he could not claim the deduction. There is no logic to this.[2]

The receipt of oil and gas advance royalties in a year before production commences is not, by any means, an unusual occurrence. Nonetheless, the Commissioner's position would allow a depletion deduction if the receipt of the advance royalty were to be deferred until a year in which there was production, but would deprive the royalty owner of a similar deduction if he were to receive his payment in a prior year. There is no sense to

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[2]In the companion case of *Philip D. Farmar, et al.*, No. 82-774, where there had been production, the Commissioner argues that only the value of the production is eligible for percentage depletion. The Commissioner evidently contends in that case that §613(a) has somehow been amended so that the lease bonus in that case is not "gross income from the property". See §613(a), Internal Revenue Code. If Congress intended §613(a) to be amended in accordance with that interpretation, it is difficult to determine why this was not done.

this distinction, Congress did not intend it, and there is nothing in §613A of the Code which states, suggests or implies the propriety of any such result.[3]

The lack of logic of the Commissioner's position can be seen by the following example. Assume that in 1975 a taxpayer receives an advance royalty of $200,000 under the condition that future production at the rate of 5% is to be offset against this advance. During each of the years 1976-1979 there is $1,000,000 of revenue derived from the property; the taxpayer has for each of these years $50,000 applied against his advance royalties. He receives no gross income during those years upon which percentage depletion may be based. For 1976-1979 the taxpayer is not entitled to percentage depletion since he has no gross income from the property. Nonetheless, the Commissioner would deny the percentage depletion deduction for 1975 because the year of the receipt of the advance royalty and the year of production did not match. If the Commissioner should alter his position so as to allow a belated depletion deduction for the years 1976-1979, then we would question any legal justification for such largess.[4]

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[3]Advance royalties are offset against royalties earned from future production. A lease bonus does not require any such future offset (see the Commissioner's brief, p. 7), and in this respect the case of the Engles is distinguishable from the companion case of *Farmar, et al.*, No. 82-774.

[4]As noted in the Commissioner's brief, p. 15, in the case of advance royalties, if the advance is not ultimately offset against royalties earned out of production, the depleton deduction must be recaptured, that is, restored to income. *Douglas v. Commissioner*, 322 U.S. 275 (1944); *Sneed v. Commissioner*, 119 F.2d 767 (5th Cir. 1941) cert. denied 314 U.S. 686 (1941) (erroneously cited in Commissioner's brief as 110 F.2d). In this respect also, the advance royalties in *Engle* appear to be different from the lease bonus in the companion case of *Farmar, et al.*, No. 82-774. The net effect of the Commissioner's position in *Engle* therefore is not merely to require that the depletion deduction be based on production, but rather to require that the taxable year of the receipt of the advance royalties match precisely with the taxable year in which production is derived, at the expense of having the percentage depletion deduction disallowed entirely.

The long practice of permitting percentage depletion regardless of whether there is production is consistent with limiting such depletion to gross income attributable to less than 2,000 barrels of oil or 12 million cubic feet of natural gas. Section 613A(c) limits percentage depletion for those whose production exceeds that limitation. The statute does not change the rules relating to, or the purpose of allowing depletion for, those who do not exceed the limitation.

When the Revenue Act of 1926 first made gross income the basis for percentage depletion, the Supreme Court ruled that the change in method of computation did not change the function of depletion as it had existed under previous revenue acts.

> *[W]hat was included in the reasonable allowance for depletion by the established construction of the earlier acts gave significant content to the word as used in the Act of 1926. There is no ground for supposing that Congress, by providing a new method for computing the allowance for depletion intended to break with the past and narrow the function of that allowance. The reasonable inference is that it did not and that depletion includes under the 1926 Act precisely what it included under the earlier acts.* United States v. Dakota-Montana Oil Company, 288 U.S. 459 (1933).

So too, the 1975 change in the method of computing depletion for large producers does not change the function of depletion as it applies to those who are not large producers.

III. THE COMMISSIONER'S ATTEMPT TO ESTABLISH LEGISLATIVE INTENT BY RELYING ON THE LEGISLATIVE HISTORY OF A BILL WHICH WAS INTRODUCED IN THE HOUSE OF REPRESENTATIVES OF A PRIOR CONGRESS, WHICH DIED IN THE EARLY STAGES OF THE ENACTMENT PROCESS, AND WHICH WAS NEVER CONSIDERED BY THE SENATE, IS UNFOUNDED.

The Commissioner relies on the report of the House Committee on Ways and Means on H.R. 17488 to establish congressional intent for §613A(c). H.R. 17488 was considered by the House of Representatives during the 2nd Session of the 93rd Congress. That bill generally repealed percentage depletion but provided exemptions for (a) small producers, (b) production from stripper wells, and (c) production from the North Slope of Alaska. H.R. 17488, 93rd Cong., 2nd Sess., 27-30 (1974). The bill was reported out by the Committee on Ways and Means but went no further. It was not reviewed by the Senate, the Finance Committee of the Senate, or any Joint Conference Committee. It simply died in 1974 after being reported out by the House Committee.

When the 1975 Act (H.R. 2166) was ordered reported to the House during the 1st Session of the 94th Congress, it did not contain a provision which eliminated percentage depletion on income from oil and gas wells. In this respect it was wholly different from H.R. 17488 of the prior Congress. The report of the House Committee on Ways and Means on H.R. 2166 did not, of course, contain any reference to percentage depletion. H.R. Rep. No. 94-19, 94th Cong., 1st Sess. (1975-1 C.B. 569). Rather, the repeal of percentage depletion was introduced into H.R. 2166 by a floor amendment in the House. That House amendment contained none of the exemptions which had appeared in H.R. 17488. Backus, A Stitch in Time Necessary to Save Lease Bonus Depletion, 55 TAXES 313, 314 (1977).

The Senate, in its consideration of H.R. 2166, added the exemption for independent producers and royalty owners. This exemption ultimately evolved into §613A(c). The Conference Committee's report on H.R. 2166 considered that exemption. H.R. Conf. Rep. No. 94-120, 94th Cong., 1st Sess. (1975) (1975-1 C.B. 624, 629-630). Nowhere in that report is there any reference to H.R. 17488 of the previous Congress. Nowhere in that report is there language which suggests that percentage depletion is to be denied for advance royalties. The Conference Committee's repeated references to "small producer" demonstrate that the barrel limitation was an attempt to define "small" and was not intended to impose a production requirement. The Committee obviously had reference to a class of producer which, by the barrel limitation, it was attempting to define. The Engles clearly fall within this class. An isolated statement in the House report for a bill introduced in a different Congress should not be used to support a contrary intent.

H.R. 17488 simply died — it did not evolve into H.R. 2166. The report for H.R. 17488 is not an indication of congressional intent for H.R. 2166. As stated by the Seventh Circuit in this case:

> *It is extremely difficult, as a matter of common sense, to conclude from this pattern that the intent of the House in 1974 remained unchanged in 1975.* (Pet. App. 9a.)

On page 26 of his brief, the Commissioner cites *Helvering v. Morgan's, Inc.*, 293 U.S. 121 (1934), and implies that to ignore H.R. 17488 is to isolate §613A(c) from its history. In *Morgan's, Inc.*, this Court considered previously enacted revenue laws to be relevant for purposes of determining the meaning of a term used in both the statute being considered by the Court and the previous statutes. This Court did not use a congressional report on a never enacted bill of a previous Congress to determine the congressional intent of a statute enacted by a subsequent Congress.

Nor is *Gemsco, Inc. v. Walling*, 324 U.S. 244 (1945), of any aid to the Commissioner. That case involved a conference committee rewrite of House and Senate bills of the same Congress. The Conference Committee rewrite picked up elements of both the House and Senate bills it was intended to combine. In that case the Conference Committee obviously considered both of the predecessor bills and did intend to combine elements of each.

For almost half a century prior to the enactment of the 1975 Act, production was not a prerequisite for percentage depletion. A reversal of such a longstanding fundamental position requires more than the expression of intent by a committee of one house of a previous Congress in connection with a bill which was never enacted.

IV. THE COMMISSIONER MAY NOT RELY ON PROPOSED REGULATIONS TO INTERPRET SECTION 613A(c).

At pages 32-34 of his brief, the Commissioner relies on Proposed Regulations on Income Tax, Section 1.613A-7(f)(1) ("the proposed regulations"), published in the Federal Register on May 13, 1977, 42 Fed. Reg. 24287 (1977), well after the transactions in question in the *Engle* case. These proposed regulations have not been implemented. They may be withdrawn or substantially changed prior to implementation.[5]. In any event, the proposed regulations could not possibly show administrative practice bearing on the Engles' position since the taxable year involved in the *Engle* case is 1975, and the proposed regulations were not published until 1977.

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[5]In a recent example of such action, two sets of regulations under §385 of the Internal Revenue Code have been proposed and later withdrawn. 45 Fed. Reg. 86438 (1980); 47 Fed. Reg. 164 (1982); Internal Revenue News Release IR-82-80, June 23, 1980, reprinted in CCH Standard Federal Tax Reporter, ¶6583, Vol. 10 (1982).

The critical phrase of the proposed regulations states that advance royalties and lease bonuses "would not be taken into account in computing the percentage depletion allowance pursuant to section 613A(c)" (Pet. App. 84a). There can be no computation of percentage depletion under §613A(c). That section does not provide for a computation. The computation is made under §613 and is based on the gross income from the property which includes, under longstanding precedents, advance royalties. The Commissioner's brief, as well as the proposed regulations would sweep under the rug the fact that percentage depletion is incalculable under §613A(c). This draft of the proposed regulations may be corrected before the regulations are implemented, if they are implemented at all.[6]

If this Court relies on proposed regulations for statutory interpretation, then what will come of the interpretation relied upon if the proposed regulations are withdrawn or changed prior to implementation? The Commissioner cites no case or any other authority where proposed regulations have been relied upon by any court to interpret anything. We suggest that it would be a great mistake to do that. Regulations have no standing until they are at least finalized.

In sharp contrast to the Commissioner's contention are the two cases he cites, allegedly in support of his position. In *National Muffler Dealers Association v. United States*, 440 U.S. 472 (1979), this Court gave weight to an interpretation of statutory language given by a regulation which had been in effect for 50 years, on which reliance had been placed for all that time, and which had withstood scrutiny by Congress many times

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[6]Under the proposed regulations the Commissioner would, however, allow *cost* depletion with respect to advance royalties and lease holders. Thus, the Commissioner has copied precisely his position, distinguishing between percentage depletion and cost depletion on the basis of imposing a production requirement for percentage depletion, which was rejected by this Court 50 years ago in *Herring v. Commissioner*, supra.

in connection with subsequent statutory reenactments. None of those factors are involved in this case. This Court also expressed the concept in *National Muffler Dealers Association* that a regulation, if it is to be given weight, must harmonize with the statute which it interprets, as well as its origin and purpose. The proposed regulations involved in this case, referring to a depletion computation to be made under §613A(c), can hardly be harmonized with §613(a) inasmuch as it is §613(a) which actually provides for the computation.

The other case cited by the Commissioner in support of his position is no better. *United States v. Correll*, 389 U.S. 299 (1967), involved a regulation prescribing an "overnight" rule with regard to a deduction for traveling expenses. This rule was initially adopted in 1940 (I.T. 3395, 1940-2 C.B. 64). The years in issue in that case were 1960 and 1961. The rule had been applied consistently in the interim, more than twenty years. In 1953 the rule was the subject of Hearings on the General Revision of the Internal Revenue Code before the House Committee on Ways and Means, 83rd Congress, 1st Session, pt. 1 at 216-219 (1953). Congress decided to allow the rule to stand without change through the enactment of the 1954 Code. *Correll* in no way supports the Commissioner's position.

We submit that no weight should be given to the proposed regulations.

CONCLUSION

The Engles request that this Court affirm the decision of the Court of Appeals for the Seventh Circuit and find that the Engles are entitled to a percentage depletion deduction for 1975 with respect to advance royalties received by them in that year.

Respectfully submitted,

THOMAS J. DONNELLY
Counsel of Record
MICHAEL J. CONLAN
Attorneys for Fred L. Engle
and Mary A. Engle, the
Respondents in No. 82-599.